

Behavioral Economics 101: Decision Making in the Context of Poverty

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Decision Making in Poverty: A Behavioral Approach

◎ Two dominant views of behavior of LI

(Bertrand, Mullainathan & Shafir, 2006)

- Rational agent view
- 'Culture of poverty' view

◎ A behavioral perspective...

A key assumption about
human psychology

Everyone is “irrational”.

Assumptions about behavior

- ◎ Traditional assumptions
 - Do NOT sufficiently account for LI behavior

- ◎ Does not suggest that
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- ◎ Instead: Subtle differences in what features of the context matter!

Overview

- ◉ What is behavioral economics?
- ◉ Key findings from BE and related fields
- ◉ Examples in the real world
- ◉ Lessons learned...

What is behavioral economics?

What is Behavioral Economics?

- ◉ Blend of multiple fields
 - Economics
 - Cognitive Psychology
 - Social Psychology
- ◉ Judgment and decision making
- ◉ Behavioral decision research

What is Behavioral Economics?

- ◉ Typical assumptions of traditional economics not accurate
 - Rational
 - Self-interested
 - Consistent
- ◉ Difference between “normative” and “descriptive” theories of behavior

What is Behavioral Economics?

A key observation of BE:

Individuals are “irrational” but often extremely *predictable*!

Understanding human behavior

- ◎ Rational agent model (normative)
 - Well-informed
 - Stable preferences
 - Controlled and calculating

- ◎ Behavioral model (descriptive)
 - Mediocre judgment
 - Malleable preferences
 - Impulsive
 - *but, behavior is often predictable!!

Two views of poverty...

- ◎ Rational choice view
 - Well defined preferences
 - Behavior is adaptation to existing conditions
- ◎ Pathology view
 - Behaviors specific to “culture of poverty”
 - Psychological pathologies, inherent judgment problems

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Neither does a great job of explaining behavior...

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- ◎ A behavioral perspective
 - Assumes LI susceptible to same types of biases
 - Must include consideration of social context

Key insights from behavioral research

Do people think “logically”?

- ◎ System 1 versus System 2
 - Intuition vs. Reasoning
- ◎ Problems with monitoring and correction

A bat and a ball together cost \$1.10. The bat costs a dollar more than the ball. How much does the ball cost?

| | |
|---|---|
| <p>◎ System 1 (intuition)</p> <ul style="list-style-type: none">• Fast• Automatic• Effortless• Associative• Slow-learning• Emotional | <p>• System 2 (reasoning)</p> <ul style="list-style-type: none">• Slow• Controlled• Effortful• Rule-based• Flexible• Neutral |
|---|---|



Intuition versus Reasoning

- ◎ Mental shortcuts developed by System I
 - Heuristics and biases
- ◎ Bounded rationality!

Mental Shortcuts in Judgment

- ◎ Loss aversion/Framing



Mental Accounting

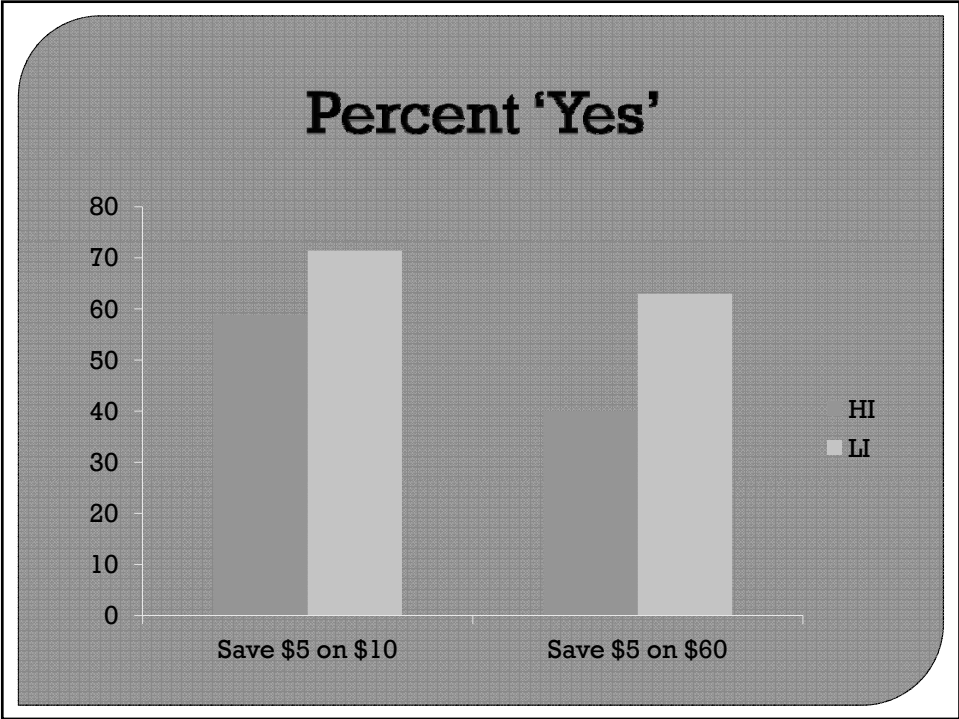
- ◉ How individual keep track of financial activity
- ◉ Set of cognitive operations
- ◉ Focus on three components
 - Perception/experience of outcomes
 - Assignment of monetary activity to “accounts”
 - Frequency of choice evaluation and bracketing
 - Violations of fungibility

An example

Imagine that you go buy a winter jacket that costs \$10 (\$60). The clerk informs you that a store twenty minutes away sells the same jacket for \$5 less. Would you go to the other store to buy the jacket?

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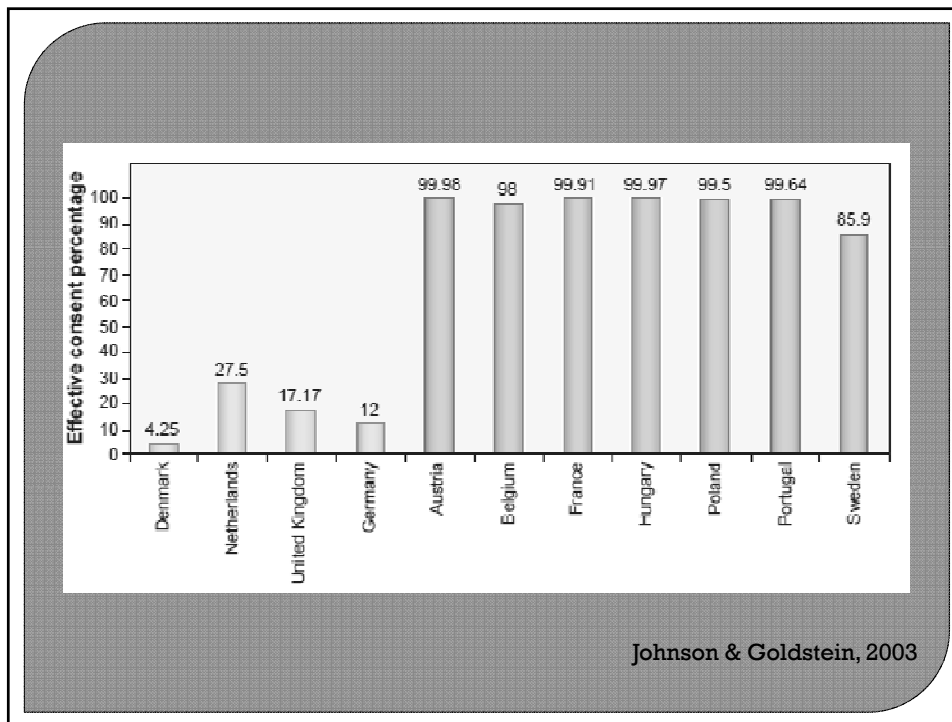
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Other concepts

- ◉ Power of defaults
 - Organ donation

Nudge, recent book by Richard Thaler and Cass Sunstein



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○ Cognitive priming

- Princeton students
- Female Asian graduate students in mathematics

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- ◎ Channel factors matter!

- Tetanus shots

So what about financial decision making
in the context of poverty?

BE in action!

◎ Purchase of lottery tickets

(Haisley, Mostafa & Loewenstein, 2008)

- Framing influences purchase of lottery tickets
 - Myopia
 - Priming of poverty

BE in action!

◎ Rent to own contracts

(Zikmund-Fisher & Parker, 1998)

◎ What *actually* explains demand?

- Risk aversion
- Financial management tool

BE in action!

○ Take up and use of savings products

- “Save more tomorrow”
- “Save every way”

Daily Saving Tips & Reminders - SaveEveryWay - Mozilla Firefox

http://www.saveeveryway.com/

UW Map Catalyst Maps Podometer Weather UW News UW NOKS Bus #2 Bus #18

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Saving Quotes, Tips & Reminders

**Our Community Is Saving Thousands Cumulatively
Come Join Us!**

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Text
Subscribers**

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Last Name

Your Mobile Number

Your Mobile Carrier

Choose Your Carrier

By confirming my cell number, I agree that I am responsible for all of my carrier text messaging charges.



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Save More Money Using The SaveEveryWay Reminder Service - It's Free

Recently a study was reported by the **Wall Street Journal**, completed by a quartet of Ivy League economists including Jonathan Zinman of Dartmouth, Sendil Mukkaidan and Margaret McConnell of Harvard and Brian Karlan of Yale showed people receiving daily reminders via text message increased their savings rate by 6%.

Their findings showed that simply keeping people aware of their spending and saving habits on a daily basis made a difference. To capitalize on this finding, this site has been set up to accomplish the same result.

SaveEveryWay will not be selling you anything, will not be sending advertisements and will not be marketing for any product or service! All expenses are paid for by donation only.


785 Followers on Twitter.com for @saveeveryway

Delivered by FeedBlitz

Grab This Widget To SaveEveryWay Tips & Reminders Blog

BE in action!

◎ Affirmation priming



Money Talks! Have You Heard?

As Much As \$4,716 — or more — Could Be Waiting for You!

You could qualify!
Did you work in 2007? You may be eligible for the Earned Income Credit — even if you don't owe income tax.

If you worked in 2007:

- Did you have one child living with you? Did you earn less than \$33,241*? You can get an EIC up to **\$2,853.**
- Did you have more than one child living with you? Did you earn less than \$37,783*? You can get an EIC up to **\$4,716.**
- If you had no children living with you, did you earn less than \$12,590* in 2007? Were you between the ages 25 and 64? You can get an EIC up to **\$428.**

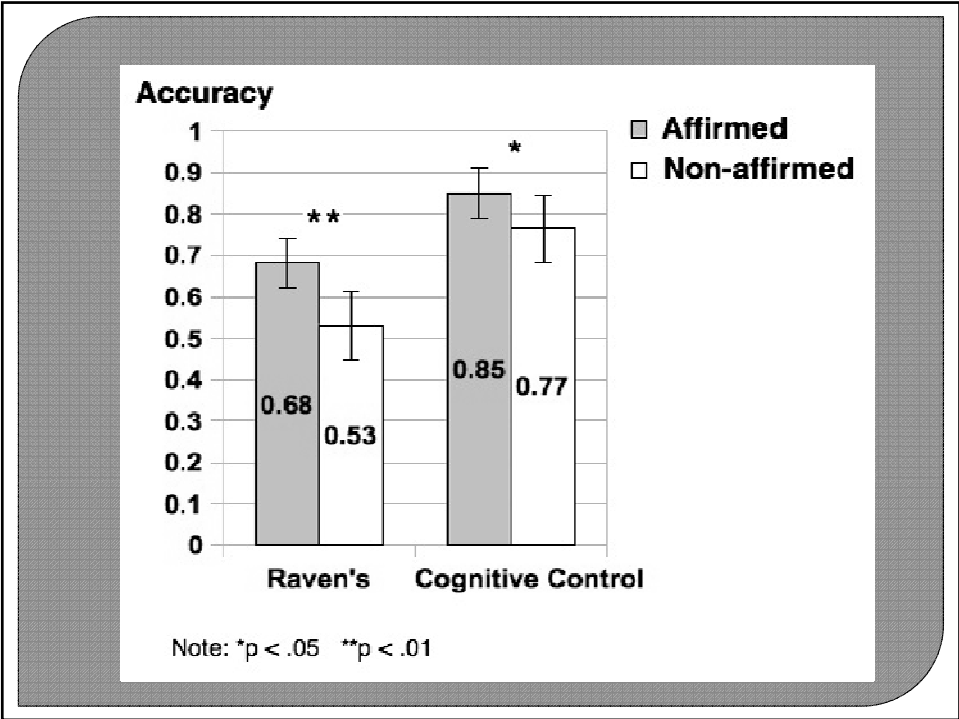
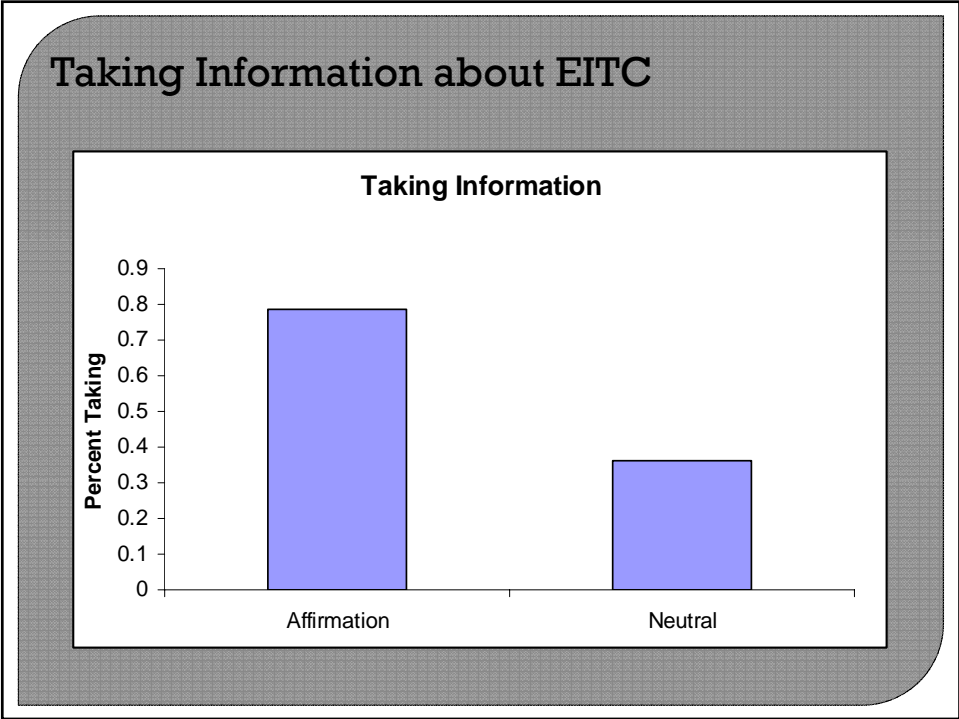
*Income limits for married workers are \$2,000 higher.

You could get a CTC refund too!
 Many families that earned more than \$11,750 may qualify for the Child Tax Credit (CTC) refund — up to \$1,000 for each qualifying child under age 17.

File a Federal Tax Return to get the EIC and CTC: Get Free Help!!!

- VITA — Volunteer Income Tax Assistance — helps people fill out returns for free.
- For a site near you, call 1-800-829-1040.

Boost your take-home pay! Eligible workers with children can get some of the EIC in their paychecks. To get the Advance EIC, get Form W-5 from your employer, or call 1-800-TAX-FORM.



Social Identity Priming

- ◉ Parental prime vs. neutral condition
- ◉ Written exercise among food bank patrons
 - N=45
 - Name children vs. favorite foods
 - Discuss goals vs. daily consumption
- ◉ Spending distribution exercise

Results of Pilot Study

- ◉ Higher percentage of money designated to savings from hypothetical \$1000 refund
 - 2% versus 11%
- ◉ Designing replication and study with actual decision making

A general model of scarcity...

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Sendhil Mullainathan and Eldar Shafir

What should I keep in mind?

The inconsistency of humans...

- **Chronic divergence between intentions and behaviors**
 - Influence of context
 - Current vs. future self



Photo: flickr user Cimm

The inconsistency of humans...

- ◎ **Chronic divergence between intentions and behaviors**
 - Influence of context
 - Current vs. future self

- ◎ **But: inconsistency \neq unpredictability!**

A two part approach

- ◉ **Understanding mechanisms/assumptions**
- ◉ **Designing and testing interventions**

The role of social context!

Decisions stem not from the objective states of the world, but the individual mental representations created of those states!

“Teach them to lower their fees and be courteous to people whether you’re dressed nice or not. Don’t make us feel invisible or beneath your grade.”

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Seattle Times, 9/23/2008

A message to banks, from a Bank on Seattle client



Questions and Comments!